Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Burton	Analyst:	Marion Mann DeJong	Bill Number:	SB 1777
Related Bills:		Telephone:	845-6979	Amended Date:	03/28/2000
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Petroleum Windfall Profits Tax/Petroleum Windfall Profits Fund

SUMMARY OF BILL

This bill would impose a Petroleum Windfall Profits Tax, at a rate to be calculated by the Franchise Tax Board (FTB), on specified taxpayers engaged in petroleum refining. Revenue from this tax would be deposited into the Petroleum Windfall Profits Fund, which this bill would create. The Controller would be required to make certain transfers from this Fund.

This bill also would exempt gross receipts from the sale, storage, use or other consumption of certain types of fuel from the state sales and use tax. This provision is not discussed in this analysis, except as it impacts the department's responsibility to calculate and collect the windfall profits tax.

SUMMARY OF AMENDMENT

The March 28, 2000, amendments deleted the provisions of the bill as introduced (relating to interest on overpayments of sales tax) and replaced them with the petroleum windfall profits tax discussed in this analysis.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment. The bill specifies that it would become operative on the 15th day after the effective date.

LEGISLATIVE HISTORY

SB 14 (1995/96) was almost identical to this bill. It exempted certain types of fuel from sales tax, created the Petroleum Excess Profits Tax and the Petroleum Excess Profits Fund. SB 14 failed passage in the Assembly Revenue and Taxation Committee.

SPECIFIC FINDINGS

Existing **federal income tax law** contains certain provisions for taxpayers in the oil and gas industry, such as an enhanced oil recovery credit, the option to use cost or percentage depletion in some circumstances, special expensing of intangible drilling and development costs, and restrictions on the foreign tax credit for foreign oil and gas extraction income.

Board Position:			Department Director	Date
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State tax law conforms to federal law on depletion and intangible drilling and development costs. California also allows an enhanced oil recovery credit equal to one-third of the federal credit for projects located within California. However, state law does not allow the foreign tax credit. Excess intangible drilling and development costs are a preference item for alternative minimum tax purposes.

Under the Bank and Corporation Tax Law (B&CTL), **this bill** would impose a Petroleum Windfall Profits Tax (Profit Tax) upon any taxpayer engaged in petroleum refining, as described in Code 324110 of the North American Industry Classification System (NAICS) Manual. The Profit Tax would be imposed on the taxpayer's gross receipts from sales in California.

This bill would require the FTB to establish the rate of the Profit Tax annually. The rate would be required to produce an amount of revenue that is estimated to be equal to the sum of: (1) the estimated total amount of sales and use tax revenue that would have been received if the sales and use tax exemption for motor vehicle fuel had not been enacted (as provided under this bill); and (2) the estimated total of the sales tax exemption that is not passed along to consumers; and (3) the estimated total amount of Profit Tax passed along to consumers in the form of increased prices for motor vehicle fuel. The Board of Equalization (BOE) would be responsible for all of these estimates.

The Profit Tax imposed under this bill would be in addition to all other taxes imposed under Chapter 2 of the B&CTL, such as the franchise tax and the minimum franchise tax. The Profit Tax would be imposed and collected in the same manner as other taxes.

This bill would create the Petroleum Windfall Profits Fund in the State Treasury. All revenue from the Profit Tax would be deposited into this Fund.

The Controller would be required to transfer to the Public Transportation Account in the State Transportation Fund an amount equal to the revenue the Public Transportation Account would have received (as estimated by the BOE with the concurrence of the Director of Finance) if this bill had not exempted motor vehicle fuel from sales and use taxes. The remainder of the Fund would be transferred to the General Fund.

Policy Considerations

This bill could be viewed as inequitable as it would impose an additional tax on a single industry that already is subject to state taxation. In addition, the bill does not limit the Profit Tax to taxpayers engaged in petroleum refining in California. As a result, taxpayers that have no petroleum refining activity in California would be subject to the tax.

Implementation Considerations

If the bill were limited to taxpayers engaged in petroleum refining in California, it would create an additional tax that would be imposed on fewer than 20 taxpayers. Changes would have to be made to the department's programs and operations to impose this new tax. Given the limited number of taxpayers, tax returns containing the Profit Tax would likely be processed manually.

The following additional implementation concerns have been identified with this bill. The department's staff is available to assist with any amendments to resolve these concerns.

- This bill implies that the Profit Tax would be imposed on an annual basis since the FTB would determine the rate annually. However, this bill also specifies that it would become operative on the 15th day after the effective date of this act, an operative date that more appropriately applies to the sales tax portion of this bill. The interaction between this operative date language and the annual rate determination is unclear. If the intent is to impose the tax annually, clarifying language should be added that the Profit Tax is imposed on gross receipts from sales in California in income years beginning on or after January 1, 2000 (or a different legislatively specified date).

- Since this tax would be imposed and collected like the franchise tax, quarterly estimated payments would be required. Taxpayers would already have made estimated payments during 2000 based on their existing tax liability. Thus, if the tax is imposed for the 2000 year, taxpayers may owe interest and penalties from failure to pay estimated taxes based on their Profit Tax liability. The author may wish to waive the interest and penalties for the 2000 year or clarify that interest and penalties are due.

- If a taxpayer underpays its tax liability, it is unclear whether the payment should be credited first to its franchise tax liability, with the remainder to the Profit Tax, or whether the insufficient payment should be proportionally divided. Also, if a taxpayer pays penalties and interest on its Profit Tax liability, it is unclear whether the amount of penalties and interest should be deposited into the General Fund or the Petroleum Windfall Profit Fund. This bill should be modified to ensure that the author's intent is achieved.

- The Profit Tax would be imposed on gross receipts from sales in California of any taxpayer engaged in petroleum refining anywhere. However, this language is not specifically limited to gross receipts from sales in California <u>from</u> petroleum refining. Therefore, a taxpayer engaged in several businesses may be required to pay the Profit Tax on all California sales, including sales not related to its refinery operation. This language should be clarified if the author intends to impose the tax only on sales from refining.

- The Profit Tax would be imposed on gross receipts of any taxpayer engaged in petroleum refining anywhere. The tax is not limited to taxpayers engaged in petroleum refining in California. Therefore, a taxpayer engaged in petroleum refining only outside California would be required to pay the Profit Tax on all California sales -- sales not related to its refinery operation. This language should be clarified if the author intends to impose the tax only on taxpayers engaged in refining in California.

- The Profit Tax revenue would be deposited into a special fund, the Petroleum Windfall Profit Fund. The department currently deposits all money received into the Personal Income Tax Fund or the Bank and Corporation Tax Fund. In cases where money is designated for a special purpose, such as a voluntary contribution fund, the department determines the appropriate amount and then informs the Controller, who makes the actual transfer. Amending the bill to establish a similar process would eliminate complicated changes to the department's accounting systems.

Technical Considerations

This bill would exempt other types of fuel besides motor vehicle fuel from state sales and use taxes and the transfers made by the Controller. However, the section of this bill that imposes the Profit Tax refers only to motor vehicle fuel tax. Since the Profit Tax was apparently intended to offset revenue loss from the sales and use tax exemption provided by the bill, fuel taxes referred to under the Profit Tax should coincide with the fuel tax exemptions enacted by the bill. Adding the other types of fuel to the Profit Tax section would provide consistency.

The bill language omits a parenthetical on page 4, line 1, after "(NAICS)". In addition, the bill refers to the NAICS, but does not specify a publication date for the manual.

FISCAL IMPACT

Departmental Costs

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved.

Tax Revenue Estimate

According to the most recent estimate by the BOE, the annual revenue from the state sales tax on motor vehicle fuels is on the order of $1.2 billion.

No projections are available for (1) that portion, if any, of the exemption from the sales or use taxes for motor vehicle fuel provided for in Section 6357.7 that is not passed on to consumers and (2) that portion, if any, of the tax imposed pursuant to this section estimated by the BOE to be passed on by taxpayers to consumers in the form of increased prices for motor vehicle fuel.

Calculating a Profit Tax is not feasible at this time since estimates for the last two components are not available from the BOE.

BOARD POSITION

Pending.